Supreme Court of the United States

OCTOBER TERM, 1946

No. 82

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

v.

FEDERAL WATER AND GAS CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR FEDERAL WATER AND GAS CORPORATION

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Opinions Below

The opinion of the Court of Appeals (R. 172-80) is reported in 154 F. (2d) 6.

The findings and opinion of the Commission which accompanied its order of February 7, 1945 (R. 128) are reported in S.E.C. Holding Company Act Release No. 5584. The prior opinions of the Commission and the courts are reported in 8 S.E.C. 893; 10 S.E.C. 200; 128 F. (2d) 303 and 318 U.S. 80.

Jurisdiction

The judgment of the Court of Appeals was entered February 4, 1946 (R. 181). The petition for writ of certiorari was filed April 8, 1946 and granted May 13, 1946 (R. 184-185). This Court appears to have juris-

diction under Section 240(a) of the Judicial Code, as amended, which is made applicable by Section 24(a) of the Public Utility Holding Company Act of 1935.

Statement

The interveners own certificates for 11,598 shares of preferred stock of Federal Water Service Corporation (R. 124) which they purchased during the period from March 8, 1937 to June 10, 1940 (R. 82, 83) in the open market, except for the acquisition by Chenery Corporation of 2700 shares of preferred stock from a securities dealer by exchanging therefor $100,000 par value of debentures of Federal Water Service Corporation on June 10, 1940 (R. 138).

The Commission by order entered on September 24, 1941 (10 S.E.C. 200) approved a merger agreement which provided that these shares owned by the interveners be surrendered to Federal Water and Gas Corporation for cost plus four per cent interest to the date of the merger agreement, except that the price for shares owned by certain interveners who had realized profits on sales was reduced so as to obtain for the corporation such profits (R. 120, 121). The decision was based upon the ground that the interveners had violated their fiduciary duties as these duties were established by courts of equity in purchasing preferred stock during a period when a reorganization plan for Federal Water Service Corporation was on file with the Commission. Upon review of the order of the Commission by the interveners, the Court of Appeals for the District of Columbia held that it should be set aside (128 F. (2d) 303) and this Court on certiorari, as

we read the opinion, affirmed the order, directing the Court of Appeals to remand the cause to the Securities and Exchange Commission for such further proceedings as may be appropriate, not inconsistent with the opinion of this Court (*Securities and Exchange Commission* v. *Chenery Corporation, et al.*, 318 U.S. 80; R. 98-111).

Federal Water and Gas Corporation thereupon applied to the Commission for leave to submit to its stockholders resolutions amending and correcting the merger agreement so as to give to the interveners the right to exchange their outstanding certificates of Federal Water Service Corporation stock for certificates of Federal Water and Gas Corporation and otherwise restore to the interveners the rights of which they had been unlawfully deprived by the Commission's order (R. 118-126).

The Commission interpreted the opinion of this Court as having sustained the Commission's power to reach the result which the Commission reached in its prior order, but as requiring the Commission to place its decision on the basis of its administrative experience instead of upon the basis of equity precedents (R. 130).

Purporting to exercise the authority which the Commission held this Court had given to it, the Commission held that if the interveners were permitted to purchase stock while a plan of reorganization was on file with the Commission, they might be tempted to abuse their fiduciary duties in order that they might purchase stock (R. 157-164); that the Commission could not enter into any inquiry as to the motives of the interveners in purchasing stock (R. 164); that it was the duty of the Commission to prevent the possibility of temptation to abuse fiduciary duties during the period when a reorganization plan was on file

with the Commission (R. 165, 166). Because of an alleged conflict of interests, the Commission held that it had doubts (R. 149) which prevented an affirmative finding of fairness and equity under Section 11(e) and for the same reasons, the Commission made the affirmative findings under Sections 7(d)(6) and 7(e) that the proposed amendment was "detrimental to the public interest and the interest of investors" (R. 149).

The Court of Appeals unanimously reversed the order of the Commission upon the ground that the findings of the Commission did not sustain its administrative conclusions. The Court of Appeals also interpreted the opinion of this Court as holding that if a new standard of fiduciary duty for officers and directors and controlling stockholders is to be promulgated by the Commission, it ought to be by rule having a prospective operation. The Court said (R. 180):

> "* * * What we do say is that, without such a rule, of which notice is given so that all may know of its existence, transactions in themselves fair and just and honest and in accord with traditional business practices, and which 'Congress itself did not proscribe,' and which 'judicial doctrines do not condemn,' may not properly be outlawed or denied' their ordinary effect."

The only facts contained in the record which appear to be material from the standpoint of the Commission's opinion are the following:

The interveners were officers or directors of Federal Water Service Corporation and Utility Operators Company and were therefore fiduciaries. Federal Water Service Corporation registered with the Commission on

November 8, 1937 under the Public Utility Holding Company Act and on the same day filed a plan of reorganization. Between November 8, 1937 and June 10, 1940 the interveners purchased shares of preferred stock of Federal Water Service Corporation at prices which the Commission held would give to the interveners a profit if, in the reorganization plan for Federal Water Service Corporation, they received common stock for their shares of preferred stock on the same basis as other stockholders of the same class. There was no specific finding as to the amount of the profit. The Commission found that the book value of the new common stock which would be issued in exchange for stock costing $328,347 would be $1,162,000, but the Commission also found that the probable market value for the new common stock was approximately $5 per share or an aggregate of $395,385 as compared with the aggregate cost of $328,347 for the stock (R. 139). The record does not show the market prices of the new common stock following the consummation of the merger.*

Summary of Argument

The Commission, in denying the application of Federal Water and Gas Corporation for leave to amend the merger agreement, made the following errors of law:

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*Moody's Ten-year Range for Public Utility Stocks (Moody's Public Utilities (1946) a71), quotes the low and high for the years 1941-45 inclusive as follows:

1941	5⅞	7¼
1942	4	8⅞
1943	10¼	13⅜
1944	12	15½
1945	17½	22½

1. It misconstrued the statutory standard "fair and equitable" in Section 11(e) of the Holding Company Act. This phrase means what it has always meant in a reorganization context that there shall be an equivalence between the rights surrendered and those received in reorganization.

2. It misconstrued the statutory standard "detrimental to the public interest or the interest of investors or consumers" in Section 7 of the Holding Company Act. Section 7 requires plans of reorganization to be in accordance with State law and the phrase cannot be construed so as to require a corporation to violate the rights of any stockholders in order to obtain the approval of the Commission.

3. It misconstrued the opinion of this Court. It held that this Court authorized it to reach the result which it had reached provided it placed its decision on the basis of its administrative experience instead of on the basis of equity precedents. This was error. This Court did not authorize the Commission to reaffirm its order. On the contrary, this Court held "But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority." The Court held that the interveners had not violated their fiduciary duties in purchasing preferred stock while a plan of reorganization was on file with the Commission as those duties were established by courts of equity. There was no other standard of fiduciary duty. This Court further held that the order could not be sustained as an exercise of administrative competence because it did not have any of the characteristics of an appropriate exercise of adminis-

trative competence. If the Commission had passed a rule which had been violated, the case would have been different.

4. It made an adminstrative decision which was not based upon the facts in the record but upon the invention of a new policy with respect to officers' and directors' and controlling stockholders' purchases of stock. If the policy is desirable, it can only be made effective through the exercise of the legislative power of the Commission. The application of a new policy as to officers' and directors' purchases in order to outlaw past transactions in a reorganization was beyond the power of the Commission. It was also arbitrary and capricious and constituted an abuse of discretion, if it was in an area where Congress authorized the Commission to exercise discretion.

Argument

FIRST

FEDERAL WATER AND GAS CORPORATION IS A "PARTY AGGRIEVED" BY THE COMMISSION'S ORDER.

The Commission's brief (p. 17) notes but does not argue the question whether Federal had standing to file a petition for review as a "person or party aggrieved" by the Commission's order within the meaning of Section 24(a) of the Holding Company Act. There is no merit in the suggestion (*Federal Power Commission* v. *Pacific Co.*, 307 U. S. 156).

SECOND

THE COMMISSION MISCONSTRUED THE STATUTORY STANDARD "FAIR AND EQUITABLE" IN SECTION 11(e) OF THE HOLDING COMPANY ACT.

It is impossible to determine whether the findings of an administrative agency meet the tests supplied by a statutory

standard without determining the meaning of the statutory phrases relied upon by the agency as the source of the power which it is exercising. Here the phrase principally relied upon by the Commission is "fair and equitable" in Section 11(e) of the Public Utility Holding Company Act. It is submitted that this phrase in the Act means what it has always meant in a reorganization context, that there shall be a fair equivalence between the rights surrendered and those received in the reorganization. Where the reorganization takes the form of a reclassification of stock, all stock of the same class must be treated in the same way.

In this case it is submitted that the Commission never had any discretion other than to make a tentative decision of a question of law. Was the fact that the interveners purchased stock while a plan of reorganization was on file with the Commission a sufficient reason in law to justify the corporation in treating this stock differently from other stock in a "fair and equitable" reorganization under the Holding Company Act?

In *Otis & Co.* v. *Securities and Exchange Commission*, 323 U. S. 624, the question was whether a plan of reorganization under Section 11(e) of the Act was "fair and equitable" to preferred stockholders when, pursuant to order of the Commission, the company was liquidated and the preferred stockholders did not receive new securities having a market value equal to the liquidating preference of the old. The question which divided the Court was whether the charter terms with respect to dissolution "voluntary or involuntary" applied to a dissolution made pursuant to Commission order under the Holding Company Act. All of the justices of this Court concurred in the view that the question presented as to the rights of the stock-

holders *inter sese* was one of law and that the phrase "fair and equitable" had the meaning always given to it in a reorganization context. Mr. Justice Reed said (p. 633):

> "We reach the conclusion that the Securities and Exchange Commission applied the correct rule of law as to the rights of the stockholders inter sese."

(p. 634):

> "Like the bankruptcy and reorganization statutes, the Public Utility Holding Company Act, in providing that plans for simplification be 'fair and equitable,' incorporates the principle of full priority in the treatment to be accorded various classes of security interests. This right to priority in assets which exists between creditors and stockholders, exists also between various classes of stockholders. When by contract as evidenced by charter provisions one class of stockholders is superior to another in its claim against earnings or assets, that superior position must be recognized by courts or agencies which deal with the earnings or assets of such a company. Fairness and equity require this conclusion."

Chief Justice Stone, in a dissenting opinion in which Justices Roberts and Frankfurter concurred (p. 648), agreed as to the fixed meaning of the phrase "fair and equitable" in Section 11(e), stating:

> "We think no other construction of § 11(e) of the present Act can be sustained. Neither the context of the statute nor the legislative history suggests any other. The Commission hints at no reason for not giving these terms of art, 'fair and equitable,' other than their long settled and hitherto accepted meaning."

The *Otis* case came to this Court under Section 25 of the Public Utility Holding Company Act on certiorari to review the decision of the Court of Appeals for the Third Circuit affirming the order of the United States District Court of Delaware entered in an enforcement proceeding under Section 11(e). The corporation and the Commission were aligned on one side and Otis & Co. was on the other, claiming that the corporation had applied an erroneous rule of law by failing to recognize its legal rights as fixed by the certificate of incorporation. This Court considered Otis & Co.'s contention as raising a question of law for the independent judgment of this Court.

The *Cheney Corporation* case came to this Court under Section 24 of the Act, on certiorari to review the decision of the Court of Appeals for the District of Columbia on direct review of an order of the Commission. The corporation and the Commission were aligned on one side; the interveners on the other. The question was similar to that in the *Otis* case—whether the Commission had applied the correct rule of law in determining the rights of the stockholders of Federal Water Service Corporation, *inter sese*.

Perhaps the difference in procedure for review tended to obscure the fact that the legal questions before the Court of Appeals on direct review of an order of the Commission holding "fair and equitable" a plan of reorganization under Section 11(e) of the Act are the same as those presented to a district court in an enforcement proceeding under Section 11(e) following a determination by the Commission that a plan of reorganization is "fair and equitable."

Where a corporation intends to enforce an 11(e) reorganization plan in a federal court, the practice is for the Commission to condition the effectiveness of its order upon its approval by the District Court. Where this is done, the

Court of Appeals will not entertain a direct review of the order of the Commission under Section 24 but will require the parties claiming to be aggrieved by the order to oppose it in the district court and in the event of an adverse order by the district court to seek review under Section 25 of the Act. (*Okin* v. *Securities and Exchange Commission*, 145 F. (2d) 206 (C. C. A. 2, 1944); *Lownsbury* v. *Securities and Exchange Commission*, 151 F. (2d) 217 (C. C. A. 3, 1945). On the other hand, where the corporation intends to put through its plan of reorganization under state law without an order of enforcement under Section 11(e), the review of the order of the Commission holding that the plan is "fair and equitable" is necessarily by the Court of Appeals and on such review the Court of Appeals will protect the rights of the parties aggrieved in the same manner as the district court in an enforcement proceeding in that Court (*Phillips* v. *Securities and Exchange Commission*, 153 F. (2d) 27 (C. C. A. 2, 1946)). Whatever the procedure for review, whether by the District Court in an enforcement proceeding or by the Court of Appeals under Section 24 the legal questions open to the Court are the same.

It was said in *Okin* v. *Securities and Exchange Commission*, *supra*, that the relationship of the Commission to the district court provided for in Section 11 is the same as that of the Interstate Commerce Commission to the district court in a railroad reorganization under Section 77 of the Bankruptcy Act. Such relationship was much considered by this Court in *Ecker* v. *Western Pacific R. Co.*, 318 U. S. 448 and *Group of Investors, Inc.* v. *Milwaukee R. Co.*, 318 U. S. 523. See, also, *Reconstruction Finance Corporation* v. *Denver and Rio Grande R. Co.*, 90 L. Ed.

p. 1134, dissenting opinion by Mr. Justice Frankfurter, rendered October 28, 1946.

In the railroad reorganization cases, the Court recognized the administrative competence of the Commission in dealing with such matters as valuation, capitalization, earnings, etc., but it determined for itself all legal questions such as were involved in the construction of mortgages in order that the plan might be fair and equitable. Mr. Justice Douglas in the *Milwaukee* case said with respect to the fair and equitable standard (p. 565):

> "It is sufficient that each security holder in the order of his priority receives from that which is available for the satisfaction of his claim the equitable equivalent of the rights surrendered."

In his concurring opinion, Mr. Justice Roberts said (p. 577):

> "Substantial equivalence satisfies the requirement of 'fairness and equity' in its legal sense as used in this setting."

Whenever the Commission under Section 11(e) of the Act finds that a plan proposed by a corporation is fair and equitable, it authorizes the corporation to "take" the property of all persons affected by the plan for the consideration set out in the plan. Unless Congress required the corporation to give a fair equivalent for the property taken, Section 11(e) of the Holding Company Act would be plainly unconstitutional, in that as so construed it would authorize the taking of property for private use without just compensation.

In the *Otis* case, Chief Justice Stone referred to the constitutional question, saying (p. 645):

> "We cannot assent to the proposition advanced by the Commission that even though the priority stipulation was intended to be applicable to any kind of an involuntary liquidation, including one such as the present, the Commission can nevertheless override it. Such provisions for priority in a corporate charter constitute a contract among the stockholders, which is entitled to constitutional protection, *Bedford* v. *Eastern Building & Loan Assn.*, 181 U. S. 227; *Hopkins Federal Savings & Loan Assn.* v. *Cleary*, 296 U. S. 315; *Treigle* v. *Acme Homestead Assn.*, 297 U. S. 189, 194-6, impairment of which is not lightly to be attributed to Congress. No constitutional issue is raised here, but we find no provision of the statute which purports to confer on the Commission, in the exercise of its power to liquidate a corporation, any authority to set aside a lawful stipulation in which the stockholders have joined fixing their relative rights in the event of liquidation."

Here the Commission has reaffirmed its order of September 24, 1941 which authorizes the corporation by an appropriate proceeding under Section 11(e) of the Act to take the property of the interveners including profits on prior sales for cost plus four per cent. The interveners have violated no standard of fiduciary duty, no rule of the Commission and no statute in purchasing the stock. No statute limits their claims to cost plus four per cent. There is absolutely nothing upon which a court of equity could rely in justification for treating the interveners' stock differently from other stock in a "fair and equitable" reorganization.

The Commission in its opinion assumed that the phrase "fair and equitable" in Section 11(e) of the Holding Com-

pany Act authorized the Commission to apply to the determination of the application of Federal Water and Gas Corporation a subjective and in substance a non-reviewable test as to whether the interveners had sustained the burden, which the Commission for policy reasons foreclosed them from sustaining, of convincing the Commission that it was "fair and equitable" to allow them to participate in the reorganization on the same basis as other stockholders. It is manifest that the Commission did not use the phrase "fair and equitable" in the sense in which this phrase was used by Congress in requiring that all plans for compliance with Section 11(b) of the Holding Company Act must be "fair and equitable to the persons affected thereby."

THIRD

THE COMMISSION MISCONSTRUED THE STATUTORY STANDARD "DETRIMENTAL TO THE PUBLIC INTEREST OR THE INTEREST OF INVESTORS OR CONSUMERS" IN SECTION 7 OF THE HOLDING COMPANY ACT.

The controlling fact underlying the interpretation of the phrase "detrimental to the public interest or the interest of investors or consumers" is that any declaration by a corporation under Section 7 must conform to the requirements of state law.

Section 7(a)(2) provides that the declaration must include such information regarding "compliance with such State laws as may apply to the act in question as the Commission may by rules and regulations or order prescribe as necessary or appropriate in the public interest for the protection of investors or consumers." The rules of the Com-

mission give effect to this provision. Subsection (g) of Section 7 expressly prohibits the Commission from permitting a declaration regarding the act in question to become effective if a State commission informs the Commission that State laws applicable to the act in question have not been complied with.

Senate Report No. 621 (74th Cong., 1st Sess., p. 28) refers to subsection (g) as follows:

> "Subsection (g) requires in all cases compliance with the applicable State laws."

Under Delaware Corporation Law, Federal Water Service Corporation was required to treat all stockholders of the same class in the same way. The phrase "detrimental to the public interest or the interest of investors or consumers" cannot be construed so as to require Federal Water Service Corporation to violate the rights of stockholders under state law in order that its declarations under Section 7 might become effective.

FOURTH

THE COMMISSION MISCONSTRUED THE OPINION OF THIS COURT AND FAILED TO GIVE EFFECT TO ITS MANDATE.

The Commission is not contending that this Court reserved decision as to what the Commission could do, if anything, in the exercise of its administrative competence. Its point is that this Court affirmatively held that the Commission was entitled to reaffirm the order that had been set aside if the Commission placed its decision on the basis of its administrative experience instead of on the basis of equity precedents.

The findings and opinion state (R. 130):

> "As we understand the opinion of the Supreme Court, our determination of 1941 in this case was held to be unsupported by certain equity precedents on which we relied. And as we construe the Supreme Court's mandate we are directed to re-examine the case on the facts, viewed in the light of that conclusion of the Court, whether our special experience in administering the legislative policy of the Act indicates a necessity for reaffirming our previous determination or whether, instead, our earlier ruling should be modified."

The Commission's brief states (p. 54):

> "This Court expressly found that the Holding Company Act provided a firm basis for the power employed by the Commission in this case (R. 107-108; 318 U. S. 90-92) and in so doing, we submit, eliminated any real issue of improper retroactivity."

In referring to the statement of the Court of Appeals, following the opinion of this Court, that the Commission could not outlaw transactions that did not fall under the ban of any standard of conduct, the Commission said (p. 21):

> "That determination is an oblique attack upon the meaning of this Court's mandate and opinion, which imposed no trammels on the Commission's powers and fully authorized the Commission to reach the result it has reached upon a clear and explicit statement of the administrative reasons justifying that result."

The Commission in its brief sets forth in lettered paragraphs the passages in this Court's opinion on which it

relies in support of its interpretation (pp. 24-32). We shall take up these passages in the order stated and comment upon them.

A. In this paragraph, (p. 24) the Commission refers to the holding of this Court that "a lax view of fiduciary obligations" would not be countenanced and that the conclusion that Federal's management were fiduciaries only began analysis as to the extent of their fiduciary obligations and the consequences of deviation therefrom. This paragraph is inconsistent with what the Commission did after remand. The Commission's opinion contains no analysis of the obligations of the interveners as fiduciaries. Nor did the Commmission give effect to the fact that this Court upon full review of the record stated that there was no evidence of any violation by the interveners of any fiduciary duty owed by them to the corporation or to its stockholders.

This Court did not hold that it was possible to have a higher standard of fiduciary duty than that maintained by courts of equity. Justice Cardozo's statement in *Meinhard* v. *Salmon*, 249 N. Y. 458, "Not honesty alone, but the punctilio of an honor the most sensitive is then the standard of behavior" is the standard applied by courts of equity. For various reasons courts of equity treat officers and directors differently from trustees. Different standards of fiduciary duty are applicable because the facts are different. This Court held (R. 108-109) that the question whether directors or officers should be prohibited from buying or selling stock during reorganization presented a problem of *policy*.

B. The Commission here (pp. 24, 25) relies upon the fact that this Court interpreted its decision as having been

predicated upon a rule of law derived from equity precedents and that the review would be confined to the grounds upon which the Commission acted since "if an order is valid only as a determination of policy or judgment which the agency alone is authorized to make and which it has not made, a judicial judgment cannot be made to serve for an administrative judgment."

It is indisputable that the Commission intended its decisions of March 24 and September 24, 1941 to be construed as this Court construed them. The Commission did not purport to invent a new policy with respect to officers' and directors' purchases and apply it retroactively to the decision of the case. It did not purport to render a decision which violated the rights of the interveners as these rights existed under state law. It did not purport to exercise any power other than the power which a court of equity would exercise in passing upon a fair and equitable plan of reorganization. The decision of the Commission that it was fair and equitable and not detrimental for Federal Water Service Corporation to treat the interveners' stock differently from other stock was treated as an administrative decision. But there was "embedded" in the administrative decision the determination by the Commission of a question of law as to whether the interveners had violated their fiduciary duties as these duties were established by courts of equity. In this view, the only question of law before the Court was whether the Commission had correctly determined the fiduciary duties of the interveners as established by equity precedents. The question whether the Commission could invent a new policy with respect to officers' and directors' purchases of stock and apply the new policy retroactively to past transactions as a reason for

outlawing securities in a reorganization was in this part of the opinion deemed not subject to review because the Commission had not purported to make that kind of administrative decision. Subsequently in the opinion this Court dealt with the question whether the order of the Commission might be sustained as an exercise of "administrative competence". And this Court held that it could not be sustained on this ground because the opinion of the Commission did not have any of the characteristics of an appropriate exercise of administrative competence. It was not a rule and if given effect it would outlaw transactions which did not fall under the ban of any standard of conduct prescribed by Congress or the Commission. If there is any inconsistency between the statement of this Court that it would confine its review only to the grounds upon which the Commission acted and the fact that this Court considered whether the Commission's decision could be upheld as an appropriate exercise of administrative competence, the inconsistency does not help the Commission. If the Court had confined its opinion to the grounds upon which the Commission had acted, it would not have made any decision with respect to the power of the Commission to take appropriate action for the correction of reorganization abuses. Certainly the Court in holding that power was conferred upon the Commission to take some action with respect to purchases of stock could also explain the power held to have been granted by stating, in substance, that it should be exercised by rule having a prospective operation and could not be relied upon as support for the Commission's decision.

C. Under this subdivision (p. 25) the Commission quotes the conclusion (R. 106) "that the Commission was

in error in deeming its action controlled by established judicial principles". The verb "control" relates back to the beginning of the discussion (R. 103) as follows:

> "On the contrary, the question before the Commission was whether the respondents, simply because they were reorganization managers, should be denied the benefits to be received by the 6,000 other preferred stockholders. Some technical rule of law must have moved the Commission to single out the respondents and deny their preferred stock the right to participate equally in the reorganization."

The inference is that unquestionably, in the view of the Court, the Commission would have permitted the interveners' stock to participate in the reorganization on the same basis as other stock unless the Commission had deemed its action controlled by a "technical rule of law".

The Commission also quotes (R. 105):

> "Determination of what is 'fair and equitable' calls for the application of ethical standards to particular sets of facts but these standards are not static. In evolving standards of fairness and equity, the Commission is not bound by settled judicial precedents. Congress certainly did not mean to preclude the formulation by the Commission of standards expressing a more sensitive regard for what is right and what is wrong than those prevalent at the time the Public Utility Holding Company Act of 1935 became law."

The phrase "fair and equitable" in Section 11(e) is used in a reorganization context meaning that there shall be an equivalence between rights given up and those received in any plan to comply with Section 11(b) of the Holding Company Act. There is no other way to determine what

rights are required to be surrendered in order to conform to the policy of the law as set forth in Section 11(b) than by consulting and following settled judicial precedents.

The Court in this passage does not state that the Commission was authorized by Congress to disregard legal rights on ethical grounds. As we understand it what the Court had in mind was that the Commission might make new rules for the future as to officers' and directors' purchases.

D. This subdivision (pp. 26-27) relates to this Court's reference to the legislative history of Sections 7 and 11(e) of the Act and its conclusion that "'Notwithstanding § 17(a) and (b), therefore, the Commission could take appropriate action for the correction of reorganization abuses found to be 'detrimental' * * *"

The Commission's brief in this Court in the *Chenery Corporation* case quoted from Senate Report No. 621 (74th Cong., 1st Sess., p. 28) with respect to the terms set forth in subsection (f) of Section 7 as follows:

> "are designed to give adequate protection to investors and consumers * * * and are in accord with the underlying purpose of the legislation to give to investors and consumers full protection against the deleterious practices which have characterized certain holding-company finance in the past * * *."

There is nothing in this provision to indicate that the treatment by a corporation in a reorganization of stockholders whose rights are the same when judged in accordance with law was a "deleterious practice". The complete statement, however, of what Senate Report No. 621 said with respect to subsection (f) is as follows (p. 28):

"Subsection (f) sets forth the terms and conditions which the Commission may prescribe in an order permitting a declaration to become effective. These terms and conditions are designed to give adequate protection to investors and consumers in the course of future financing by companies in holding-company systems and to ensure that future developments are dictated by, and not detrimental to, the business needs of integrated units and are in accord with the underlying purpose of the legislation to give to investors and consumers full protection against the deleterious practices which have characterized certain holding-company finance in the past. They embrace matters of financial practices, the granting of preemptive rights, the giving of options, the taking of competitive bids, and similar matters which vitally affect the interest of the investor or the consumer in matters of more than local concern."

This quotation clarifies what was intended. The Senate bill, S. 2796, which accompanied Senate Report No. 621, contained very specific provisions with respect to types of securities which were to be permitted. It was these terms that were "designed to give adequate protection to investors or consumers in the course of future financing."

The House amended S. 2796 by striking out all of the Senate bill after the enacting clause (House Report No. 1903, 74th Cong., 1st Sess., p. 65) and in conference the terms of the Public Utility Holding Company Act of 1935 were agreed upon. The Conference Report (House No. 1903, 74th Cong., 1st Sess.) contained the following with respect to 7(f) (p. 67):

"The Senate Bill provides (Sec. 7(f)) that securities are to be issued subject to terms and conditions

> to be prescribed by rules and regulations of the Commission and goes into detail with respect to what such terms and conditions may require. The House amendment contains no such provision. The substitute agreed to in conference authorizes the Commission to prescribe terms and conditions to assure compliance with the conditions specified in the section."

This Court also quoted (R. 107) from an extract in the Commission's brief from Senate Report No. 621 with respect to Section 11 as follows:

> "Under these subsections 11(d), (e), and (f), Commission approval of reorganization plans and supervision of the conditions under which such plans are prepared will make it impossible for a group of favored insiders to continue their domination over inarticulate and helpless minorities, or even as is often the case, majorities." *Id.*, p. 33.

The legislative history of Section 11(e) was before this Court in the *Otis* case and also again in *American Power & Light Co.* v. *Securities and Exchange Commission*, decided November 25, 1946. The history confirms only the view that the protection to be given to the public by Sections 11(d), (e) and (f) should be in accordance with legal standards applied by the Commission and the federal courts acting in cooperation.

It is submitted that what this Court meant by appropriate action for the correction of reorganization abuses was the passage of a rule having prospective operation prohibiting the purchase of stock by officers and directors and controlling stockholders on the ground that such purchases might have some relation to the reorganization

process under the Act. If the Court considered that reaffirmance of the order was "appropriate action for the correction of reorganization abuses", it would have sustained the order.

E. The Commission here (p. 27) attempts to deal with the reasons given by this Court for its decision that the Commission's order could not be sustained as an exercise of the Commission's administrative competence. This Court said (R. 108-109):

> "Through its preoccupation with the special problems of utility reorganizations the Commission accumulates an experience and insight denied to others. Had the Commission, acting upon its experience and peculiar competence, promulgated a general rule of which its order here was a particular application, the problem for our consideration would be very different. Whether and to what extent directors or officers should be prohibited from buying or selling stock of the corporation during its reorganization, presents problems of policy for the judgment of Congress or of the body to which it has delegated power to deal with the matter. Abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions unconcerned with the fairness of a particular transaction. But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority. Congress itself did not proscribe the respond-

> ents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions. Nor has the Commission, acting under the rule-making powers delegated to it by § 11(e), promulgated new general standards of conduct."

No reason is given by the Commission in its brief why these passages from this Court's opinion should not have been deemed controlling upon the Commission following remand. The Commission's brief shows by asterisks (p. 27) the omission of the sentence: "But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority."

This Court said (R. 110):

> "It is not for us to determine independently what is 'detrimental to the public interest or the interest of investors or consumers' or 'fair or equitable' within the meaning of §§ 7 and 11 of the Public Utility Holding Company Act of 1935."

The Commission refers to this statement (p. 29) as a declaration "that the Court could not assume for itself the Commission's duty of determining whether the management's activities were detrimental to the investor interests or unfair and inequitable in contravention of the standards of Sections 7 and 11 of the Act." It is manifest that the Court could not have affirmed the power of the Commission to reach the result which it did unless it determined the meaning of the statutory phrases upon which the Commission

relied as the source of its power. The word "independently" means that the Court did not consider it to be its duty to determine what the statutory standards meant until after the Commission had given its interpretation of the statutory standards.

The next sentence in this Court's opinion (R. 110):

> "The Commission's action cannot be upheld merely because findings might have been made and considerations disclosed which would justify its order as an appropriate safeguard for the interests protected by the Act."

the Commission translates in its brief as follows (p. 29):

> "Speaking negatively—because the Commission had not stated the necessary findings and considerations—this Court indicated that the Commission's order might have been upheld if findings had been made and considerations disclosed, "which would justify its order as an appropriate safeguard for the interests protected by the Act."

The Court's statement meant merely that having determined to confine its review to the question of law which the Court said was presented, it was expressly disclaiming intruding its judgment upon any matter which the Commission might deem to be before it following remand.

The Commission quotes (pp. 30-31) the following:

> "In finding that the Commission's order cannot be sustained, we are not imposing any trammels on its powers. We are not enforcing formal requirements. We are not suggesting that the Commission must justify its exercise of administrative discretion in any particular manner or with artistic refinement. We are not sticking in the bark of words. We

> merely hold that an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained."

This passage, of course, does not help the Commission in its attempt to use the opinion of this Court affirmatively as sustaining its power to reach the result which it reached by changing its opinion. In fact these words are inconsistent with such an interpretation as it certainly would be dignifying form over substance if the meaning of the opinion was that because the Commission cited equity precedents in support of the policy set forth in its opinion of March 24, 1941, that opinion could not be sustained, but if the Commission had omitted reference to equity precedents and had referred to its administrative competence, the order could be sustained. This in our view would be "sticking in the bark of words".

The grounds upon which the Commission acted in the present case were that the interveners had violated their fiduciary duties in purchasing preferred stock while a plan of reorganization was on file with the Commission. The only standard of fiduciary duty which was in existence was that established by courts of equity. The Commission had not exercised its administrative competence in promulgating a rule establishing a new standard of fiduciary duty or a new policy with respect to officers' and directors' purchases which had been violated. Accordingly, the order of the Commission could not be sustained.

FIFTH

THE GROUNDS UPON WHICH THE COMMISSION BASED ITS DECISION WERE PERTINENT TO AN INQUIRY AS TO THE ADVISABILITY OF PROMULGATING A RULE WITH RESPECT TO OFFICERS' AND DIRECTORS' PURCHASES OF STOCK. THEY AFFORD NO BASIS FOR THE COMMISSION'S ADMINISTRATIVE DECISION DISPOSING OF THE INTERVENERS' PROPERTY AND DENYING FEDERAL WATER AND GAS CORPORATION'S APPLICATION FOR LEAVE TO AMEND THE MERGER AGREEMENT.

In Point II of the Commission's brief, the Commission attempts to support its present decision upon the ground that the findings disclose "a rational and competent exercise of its administrative discretion in the application of the statutory standards." There is no discussion by the Commission of the standard "fair and equitable" in Section 11(e) or "detrimental to the public interest or the interest of investors or consumers" in Section 7. The Commission states (p. 36) that it deemed it necessary to exercise fully for the protection of investors the powers which Congress had given it to supervise the reorganization process in order to eliminate detrimental practices in reorganization and, in the words of the Committee report, to "make it impossible for a group of favored insiders to continue their domination over inarticulate and helpless minorities, or even as is often the case, majorities." (S. Report No. 621, 74th Cong., 1st Sess. p. 33; R. 152).

The basis for the Commission's decision is that it considered the purchase of stock by officers and directors and controlling stockholders after the corporation had filed a plan with the Commission when followed by an increase in

value above cost, was a detrimental practice prejudicial to investors.

Section 7 authorizes registered holding companies and subsidiaries to file declarations with the Commission in such form as the Commission may "by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers".

Section 11(e) authorizes registered holding companies and subsidiaries to submit plans to the Commission "in accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers.".

It is apparent that what the Commission is attempting to do in this case is to take action by administrative decision which, if taken at all, should be taken by rule or order governing the filing of applications and declarations under Sections 7 and 11(e).

The Commission contends that the question whether the Commission has been authorized to take action with respect to officers' and directors' purchases of stock by rule or administrative decision is not a proper subject for judicial review. The Commission says (pp. 57-58):

> "Since the Commission and not the court below had the responsibility of deciding whether to restrict itself to laying down standards applicable to future cases or whether it should apply the fair and equitable standard to limit the management's purchases to cost in this case, we submit that the reversal of the Commission's order by the court below was an improper substitution of that court's judgment for the judgment of the Commission."

If Congress had expressly authorized the Commission to take action by rule with respect to officers' and directors' purchases, it would not be contended that the Commission had authority to exercise the delegated power by administrative decision. The Commission here is seeking to exercise an implied power which this Court held had been conferred upon the Commission by the Holding Company Act. Every reason of justice and fair play supports the view that the implied power be held to be one to act by rule or order having prospective operation rather than by rule or order outlawing transactions in a reorganization which did not fall under the ban of any standard of conduct.

The question is one of construction of the Holding Company Act. And where Congress did not indicate that it had any policy at all with respect to officers' and directors' purchases of stock except that set forth in Section 17, it would seem that the formulation of a policy in this regard must be in pursuance of delegated legislative power. The difference between legislative and judicial action is well established. In *Prentis* v. *Atlantic Coast Line*, 211 U. S. 210, this Court said (p. 226):

> "A judicial inquiry investigates, declares and enforces liabilities as they stand on present or past facts and under laws supposed already to exist. That is its purpose and end. Legislation on the other hand looks to the future and changes existing conditions by making a new rule to be applied thereafter to all or some part of those subject to its power."

Because of the refusal of the Commission to recognize that there is any difference between its power to act in a legislative capacity for the protection of investors against possibilities which the Commission considered to be inherent

in the purchase of stock by officers and directors and controlling stockholders and its power to act in a quasi-judicial capacity in passing upon the fairness and equity of Federal Water and Gas Corporation's proposal to amend the merger agreement, the Commission made a most extraordinary administrative decision. The Commission relied upon what other companies could or might do as a justification for its order taking the property of the interveners and giving it to the corporation for the benefit of other stockholders. Of course, the Commission could rely upon what other companies did in justification for legislative action of the so-called "root and branch" type. See opinion of Judge Learned Hand in *Morgan Stanley & Co.* v. *Securities Exchange Commission*, 126 F. (2d) 325, 332, cited by this Court in its opinion (R. 108). But to refer to what other companies did or might do in a quasi-judicial decision disposing of the interveners' property was beyond the pale of reasonable administrative action.

So also, the decision makes the most extraordinary use of the principle of "official notice". To a limited extent, an administrative agency can rely upon facts which have come to its attention and about which there cannot be any reasonable dispute, even though they are not in the record. Even this authority has been limited by the recent "Administrative Procedure Act", which provides (Section 7(d)):

> "Where any agency discretion rests on official notice of a material fact not appearing in the evidence and the record, any party shall on timely request be afforded an opportunity to show the contrary."

But the facts referred to by the Commission as providing the setting (R. 156) by which the Commission should judge

the rights of the interveners are not of the character of which administrative bodies can take official notice. Upon their face they appear to be imaginary possibilities which have been conjured up by the writer of the opinion to meet the exigencies of this case. The phrase "administrative experience" connotes actual happenings that have come to the attention of the Commission, and unless the conclusions are based upon facts they are not based upon "experience."

To take one example: the facts in this record support the conclusion that the officers and directors of Federal Water Service Corporation had no power whatever to put through a reorganization unless it was satisfactory to the Commission and they had no power to influence the Commission in the slightest degree as to "the ultimate allocation of new securities among the various existing classes." Nevertheless, the Commission, without the support of any facts in the record, states in its opinion (R. 156):

> "The combination of these multiple powers in the management while a reorganization is under consideration places at its command a formidable battery of devices that would enable it, if it should choose to use them selfishly, to affect in material degree the ultimate allocation of new securities among the various existing classes, to influence the market for its own gain, and to manipulate or obstruct the reorganization required by the mandate of the statute."

This, of course, is mere rhetoric and as applied to the facts in this case is unfair rhetoric and illegal rhetoric because it purports to be based upon private information which the Commission has not placed in the record (*Interstate Com-*

merce Commission v. Louisville & Nashville R. R. Co., 227 U. S. 88, 91, 93; *Chicago Junction Case*, 264 U. S. 258, 263).

With respect to the Class B stock it may be noted that prior to November 8, 1937, and at all subsequent times, it was clear to the Commission and its staff that the Class B stock did not wish to use its voting power in order to obtain for the Class B stock any interest in assets or earnings. The purpose of the capital reduction plan, which the Class B stock at all times was desirous of voting for, was to pay dividends upon the preferred stock, leaving the relative rights of the preferred stock, Class A stock and Class B stock unchanged and the Commission's powers under Section 11(b) unimpaired. In view of this attitude of the Class B stock, it seems particularly out of place for the Commission in its brief (p. 41) to include the following footnote:

> "The Commission noted that 'many unsupervised reorganizations have been accomplished by first stopping dividends and starving the non-voting preferred stock to the point of desperation, then wielding the voting power of the junior stock as a weapon to force ultimate reorganization on terms unduly favorable to the latter. The management of a holding company is in a peculiarly strategic position to know the meaning of the non-payment of dividends, and what can be done to remove blocks in the flow of earnings from subsidiaries" (R. 156, Note 24).

It is true that this was said with respect to a power that management *could* exercise and it is not stated that the Class B stock in the present case *did* exercise it. But this only goes to show that the so-called "setting" in which the Commission judged the rights of the interveners was not a

"setting" at all. The findings in the opinion purporting to be based upon its administrative experience were appropriate to an inquiry as to the desirability of new legislation prohibiting innocent as well as guilty transactions, but could not be used in a judicial determination of the interveners' rights.

The Court of Appeals correctly stated the facts in the record as follows (R. 174):

> "Accordingly, we had then, as we have now, a case in which there is not one jot or tittle of evidence tending to contradict petitioners' declared purpose in the purchase of preferred stocks to be the transfer of their interest from one class, declared by the Commission to be worthless, to another with voting rights, in order that to some extent they might make, as they thought, a safe investment and at the same time preserve some interest in a company to which they had devoted a considerable part of their business lives."

It is submitted that the right of the interveners to be treated in the reorganization on the same basis as other stockholders was protected by the Constitution and the Public Utility Holding Company Act. It was not left by Congress to the discretion of the Commission. If, however, this Court should hold otherwise; if the action of the Commission is in an area where Congress gave to the Commission discretion, such discretion, it is submitted, cannot be exercised arbitrarily or capriciously. There are no facts in the record which justified the Commission's order. And a decision without facts to support it is arbitrary.

CONCLUSION

The judgment of the Court of Appeals for the District of Columbia should be affirmed.

Respectfully submitted,

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December, 1946.

APPENDIX OF STATUTES AND RULES

Public Utility Holding Company Act of 1935
49 Stat. 803, 15 U. S. C. Sec. 79

NECESSITY FOR CONTROL OF HOLDING COMPANIES

SECTION 1. * * *.

(b) Upon the basis of facts disclosed by the reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session), the reports of the Committee on Interstate and Foreign Commerce, House of Representatives, made pursuant to H. Res. 59 (Seventy-second Congress, first session) and H. J. Res. 572 (Seventy-second Congress, second session) and otherwise disclosed and ascertained, it is hereby declared that the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas, are or may be adversely affected—

(1) when such investors cannot obtain the information necessary to appraise the financial position or earning power of the issuers, because of the absence of uniform standard accounts; when such securities are issued without the approval or consent of the States having jurisdiction over subsidiary public-utility companies; when such securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from intercompany transactions, or in anticipation of excessive revenues from subsidiary public-utility companies; when such securities are issued by a subsidiary public-utility company under circumstances which subject such company to the burden of supporting an overcapitalized structure and tend to prevent voluntary rate reductions;

(2) when subsidiary public-utility companies are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm's-length bargaining or from restraint of free and independent competition; when service, management, construction, and other contracts involve the allocation of charges among subsidiary public-utility companies in different States so as to present problems of regulation which cannot be dealt with effectively by the States;

(3) when control of subsidiary public-utility companies affects the accounting practices and rate, dividend, and other policies of such companies so as to complicate and obstruct State regulation of such companies, or when control of such companies is exerted through disproportionately small investment;

(4) when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties; or

(5) when in any other respect there is lack of economy of management and operation of public-utility companies or lack of efficiency and adequacy of service rendered by such companies, or lack of effective public regulation, or lack of economies in the raising of capital.

(c) When abuses of the character above enumerated becomes persistent and wide-spread the holding company becomes an agency which, unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate com-

merce or in activities which directly affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title.

* * *

UNLAWFUL SECURITY TRANSACTIONS BY REGISTERED HOLDING AND SUBSIDIARY COMPANIES

SEC. 6. (a) Except in accordance with a declaration effective under section 7 and with the order under such section permitting such declaration to become effective, it shall be unlawful for any registered holding company or subsidiary company thereof, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, directly or indirectly (1) to issue or sell any security of such company; or (2) to exercise any privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security of such company.

* * *

DECLARATIONS BY REGISTERED HOLDING AND SUBSIDIARY COMPANIES IN RESPECT OF SECURITY TRANSACTIONS

SEC. 7. (a) A registered holding company or subsidiary company thereof may file a declaration with the Commission, regarding any of the acts enumerated in subsection (a) of section 6, in such form as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers. Such declaration shall include—

(1) such of the information and documents which are required to be filed in order to register a security under section 7 of the Securities Act of 1933, as amended, as the Commission may by rules and regulations or order prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers; and

(2) such additional information, in such form and detail, and such documents regarding the declarant or any associate company thereof, the particular security and compliance with such State laws as may apply to the act in question as the Commission may by rules and regulations or order prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers.

(b) A declaration filed under this section shall become effective within such reasonable period of time after the filing thereof as the Commission shall fix by rules and regulations or order, unless the Commission prior to the expiration of such period shall have issued an order to the declarant to show cause why such declaration should become effective. Within a reasonable time after an opportunity for hearing upon an order to show cause under this subsection, unless the declarant shall withdraw its declaration, the Commission shall enter an order either permitting such declaration to become effective as filed or amended, or refusing to permit such declaration to become effective. Amendments to a declaration may be made upon such terms and conditions as the Commission may prescribe.

(c) The Commission shall not permit a declaration regarding the issue or sale of a security to become effective unless it finds that—

(1) such security is (A) a common stock having a par value and being without preference as to dividends

or distribution over, and having at least equal voting rights with, any outstanding security of the declarant;

* * *

(d) If the requirements of subsections (c) and (g) are satisfied, the Commission shall permit a declaration regarding the issue or sale of a security to become effective unless the Commission finds that—

* * *

(6) the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interest of investors or consumers.

(e) If the requirements of subsection (g) are satisfied, the Commission shall permit a declaration to become effective regarding the exercise of a privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security unless the Commission finds that such exercise of such privilege or right will result in an unfair or inequitable distribution of voting power among holders of the securities of the declarant or is otherwise detrimental to the public interest or the interest of investors or consumers.

(f) Any order permitting a declaration to become effective may contain such terms and conditions as the Commission finds necessary to assure compliance with the conditions specified in this section.

(g) If a State commission or State securities commission, having jurisdiction over any of the acts enumerated in subsection (a) of section 6, shall inform the Commission, upon request by the Commission for an opinion or otherwise, that State laws applicable to the act in question have not been complied with, the Commission shall not permit a declaration regarding the act in question to become effective

until and unless the Commission is satisfied that such compliance has been effected.

SIMPLIFICATION OF HOLDING-COMPANY SYSTEMS

SEC. 11. (a) It shall be the duty of the Commission to examine the corporate structure of every registered holding company and subsidiary company thereof, the relationships among the companies in the holding-company system of every such company and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which the corporate structure of such holding-company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system.

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

* * * * *

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary compa-

nies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

The Commission may by order revoke or modify any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the conditions upon which the order was predicated do not exist. Any order made under this subsection shall be subject to judicial review as provided in section 24.

(c) Any order under subsection (b) shall be complied with within one year from the date of such order; but the Commission shall, upon a showing (made before or after the entry of such order) that the applicant has been or will be unable, in the exercise of due diligence to comply with such order within such time, extend such time for an additional period not exceeding one year if it finds such extension necessary or appropriate in the public interest or for the protection of investors or consumers.

(d) The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission

as sole trustee, to hold or administer under the direction of the court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and, subject to such terms and conditions as the court may prescribe, may make such disposition in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing. Such reorganization plan may be proposed in the first instance by the Commission, or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization.

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provision of such plan. If, upon any such application, the court, after notice

and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

* * *

(g) It shall be unlawful for any person to solicit or permit the use of his or its name to solicit, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, any proxy, consent, authorization, power of attorney, deposit, or dissent in respect of any reorganization plan of a registered holding company or any subsidiary company thereof under this section, or otherwise, or in respect of any plan under this section for the divestment of control, securities, or other assets, or for the dissolution of any registered holding company or any subsidiary company thereof, unless—

(1) the plan has been proposed by the Commission, or the plan and such information regarding it and its sponsors as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers has been submitted to the Commission by a person having a bona fide interest (as defined by the rules and regulations of the Commission) in such reorganization;

(2) each such solicitation is accompanied or preceded by a copy of a report on the plan which shall be made by the Commission after an opportunity for a

hearing on the plan and other plans submitted to it, or by an abstract of such report made or approved by the Commission; and

(3) each such solicitation is made not in contravention of such rules and regulations or orders as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers.

Nothing in this subsection or the rules and regulations thereunder shall prevent any person from appearing before the Commission or any court through an attorney or proxy.

* * *

(e) It shall be unlawful for any person to solicit or to permit the use of his or its name to solicit, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, any proxy, power of attorney, consent, or authorization regarding any security of a registered holding company or a subsidiary company thereof in contravention of such rules and regulations or orders as the Commission deems necessary or appropriate in the public interest or for the protection of investors or consumers or to prevent the circumvention of the provisions of this title or the rules, regulations, or orders thereunder.

OFFICERS, DIRECTORS, AND OTHER AFFILIATES

SEC. 17. (a) Every person who is an officer or director of a registered holding company shall file with the Commission in such form as the Commission shall prescribe (1) at the time of the registration of such holding company, or within ten days after such person becomes an officer or director, a statement of the securities of such registered holding company or any subsidiary company thereof of which he is, directly or indirectly, the beneficial owner, and (2) within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, a statement of such ownerships as of the

close of such calendar month and of the changes in such ownership that have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by any such officer or director by reason of his relationship to such registered holding company or any subsidiary company thereof, any profit realized by any such officer or director from any purchase and sale, or any sale and purchase, of any security of such registered holding company or any subsidiary company thereof within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the holding company or subsidiary company in respect of the security of which such profit was realized, irrespective of any intention on the part of such officer or director in entering into such transaction to hold the security purchased or not to repurchase the security sold for a period of more than six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the company entitled thereto or by the owner of any security of such company in the name and in the behalf of such company if such company shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not cover any transaction where such person was not an officer or director at the times of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may, as necessary or appropriate in the public interest or for the protection of investors or consumers, exempt as not comprehended within the purpose of this subsection. Nothing in this subsection shall be construed to give a remedy in the case of any transaction in respect of which a remedy is given under subsection (b) of section 16 of the Securities Exchange Act of 1934.

RULES, REGULATIONS, AND ORDERS

SEC. 20. (a) The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as it may deem necessary or appropriate to carry out the provisions of this title, including rules and regulations defining accounting, technical, and trade terms used in this title. Among other things, the Commission shall have authority, for the purposes of this title, to prescribe the form or forms in which information required in any statement, declaration, application, report, or other document filed with the Commission shall be set forth, the items or details to be shown in balance sheets, profit and loss statements, and surplus accounts, the manner in which the cost of all assets, whenever determinable, shall be shown in regard to such statements, declarations, applications, reports, and other documents filed with the Commission, or accounts required to be kept by the rules, regulations, or orders of the Commission, and the methods to be followed in the keeping of accounts and cost-accounting procedures and the preparation of reports; in the segregation and allocation of costs, in the determination of liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the keeping or preparation, where the Commission deems it necessary or appropriate, of separate or consolidated balance sheets or profit and loss statements for any companies in the same holding-company system.

* * *

(d) * * * No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or order of the Commission, notwithstanding that such rule, regulation, or order may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

Rules of the Commission in Effect June 1, 1938, Code of Federal Regulations, Title 17, p. 1084, Et Seq.

250.0-4. **Reservation of constitutional or legal rights.** (a) Any person filing, signing, or certifying to, any notification, statement, application, declaration, report, or other document pursuant to the Act, the rules and regulations, or any order of the Commission under the Act or the rules and regulations in this part, may include therein in behalf of such person or of any other person affected thereby an express reservation of, and refusal to waive, any constitutional or legal rights. If the reservation or refusal to waive asserted by or on behalf of any such person or persons shall be held invalid or inoperative by any court of competent jurisdiction, such filing, signing, or certifying may, at the option of any such person or persons, be deemed to have been void and of no effect from any date specified in written notice given to the Commission, by or in behalf of such person or persons, except that the validity of transactions which otherwise might be impaired by reason of the voidance and ineffectiveness of such filing, signing or certifying, shall not be effected thereby.

(b) The acceptance of any order, rule, or regulation, or the compliance with any provision of the Act, of the rules and regulations, or of any order or direction of the Commission shall not be deemed a waiver of any constitutional or legal rights. [Rule U-4]

* * *

250.12e-4. **Applications for reports on plans.** (a) Any person having a bona fide interest (as defined by §250.12e-1) in a reorganization of a registered holding company or a subsidiary of such a company may apply to the Commission for a report on a reorganization plan for such company which such person has submitted to the Commission in writing. Any number of persons may join in such an application. Every such application shall comply with the provisions of §250.0-2 as to number of copies, form and

execution. In addition to giving the name and address of each applicant for such report, every such application shall set forth the name and address of the person to whom the Commission should address correspondence with respect to such application; the name and address of the company to be reorganized; and the nature of the bona fide interest of each applicant in the proposed reorganization. A copy of the plan and of the reorganization agreement (if any) should be attached as exhibits. Insofar as applicable to the situation, each such application should also contain—

(1) A description of any proceedings before a court or other governmental body in connection with such reorganization, giving the date when such proceedings were instituted and describing briefly the history and present status thereof;

(2) (i) Financial statements of the company and its subsidiaries as of the most recent date available,

(ii) Earnings and surplus statements of the company and its subsidiaries as shown by their books for the 5 fiscal years next preceding the date of the application,

(iii) Pro forma balance sheets and earnings statements giving effect to the proposed transactions and to any adjustments proposed to be made in the accounts of the reorganized company;

(3) A brief description of the classes, amounts and rights of the owners of securities and of any substantial undisputed claims against such company, and of all changes in such rights to be effected by such plan;

(4) A statement as to the nature of any substantial presently existing claims or actions (i) against the company and (ii) on behalf of the company or the holders of its securities against any other person, (other than those referred to in paragraph (3)), and as to the results of any investigations made by or for the applicants and of any

significant investigations by courts, trustees, State commissions, or other bodies or persons that are available to applicants concerning the existence and validity of such claims, and the recommendations of the applicants with respect to the appropriate action to be taken in connection therewith;

(5) A statement of the nature and results of any important investigations made by or for the applicants as to the recent or present condition, adequacy or efficiency of the properties, operations, rates, management, accounting practices, depreciation, financial and other policies of such company and its subsidiaries; a statement of any important changes in such respects that are expected to result from or to follow the proposed reorganization; and a citation of any important public or private reports on any such matters that are known by the applicants to have been made within 5 years prior to the filing of the application;

(6) A statement of the reasons why the present is deemed to be an appropriate time to effect the proposed reorganization;

(7) A statement as to the history of the formulation and negotiation of the plan and the reasons why the applicants deem it to be fair and equitable, including a statement as to the estimates of future earnings and requirements of further capital for improvements, extensions and other corporate purposes that were used in formulating the plan; the reasons for selecting the types of new securities to be issued and the consideration that has been given to the requirements of paragraphs (c) and (d) of section 7 (49 Stat. 815, 816; 15 U. S. C., Sup., 79g (c), (d)); the principles on which such securities were allocated among the owners of outstanding securities and claims; and the extent to which such plan will effect or aid in the ultimate simplification of the corporate structure of the holding company system of which such company is a member and in carrying out the other purposes of section 11 (b) (49 Stat. 820; 15 U. S. C., Sup., 79k (b));

(8) A comprehensive statement giving the names and addresses of all persons (including, in the case of a company plan, the officers and directors of such company) who were primarily responsible for the preparation and negotiation of the plan and the class of securities or claims represented by each, the names and addresses of the persons at whose request or on whose behalf each such negotiator was acting and the names of their important legal, accounting, engineering and financial advisers, all important relations now existing or which have existed within 5 years prior to the date of such application between all such persons and the company to which the plan relates, every subsidiary thereof and every company of which it is a subsidiary, whether as officers, directors, underwriters or otherwise (if any such person does not purport to be an independent representative of a single class of securities or claims, a general statement of his position and relationships may be substituted for the data above specified in this subparagraph); the amounts of each class of securities of and claims against each such company that were beneficially owned by each such person as of a date not more than 20 days prior to the filing of the application, and a list, by individuals, giving the applicant's best information as to all purchases and all sales of such securities, within a period of 3 years prior to the filing of the application, in which any such person had a beneficial interest, the prices at which each such purchase and sale was made and a statement as to the nature of the investigations made in connection with the preparation of such list and the basis for the information therein contained;

(9) A statement as to the amounts that each person described in subparagraph (8) (including attorneys and other principal advisers) have already received as compensation and expenses for their services in connection with such reorganization and solicitation; the principles or bases on which further compensation of such persons will be determined, including, in so far as practicable, the rates

per hour or per day that will be charged or requested for the services of such persons and the respective classes of their employees, together with estimates of the maximum amount of time such respective classes of service will consume; the sources from which such compensation has been, and such further compensation is to be received; a statement of any agreements or understandings between firms of attorneys, accountants or other experts with respect to division of their respective fees; a statement as to whether the amounts of any further compensation are to be subject to determination or review by any court, governmental agency or independent person; and a statement of all agreements, understandings, or arrangements that have been entered into by or with any such person, his attorneys or other principal advisers with respect to future employment, underwritings and similar matters: Provided, That in the case of a plan of reorganization to be submitted by a company to its security holders, which is not proposed in connection with or in anticipation of any court proceeding, estimates in reasonable detail, showing the aggregate fees and expenses to be incurred in connection with such plan may be substituted in lieu of the above information;

(10) The names and addresses of any committees and any holders of substantial amounts of securities or claims who have indicated opposition to the proposed plan;

(11) A statement as to the willingness of the applicants to mail notice of the Commission's public hearing on the application to the holders of securities and claims affected by the plan, and as to the access of the applicants to lists of holders of any such securities payable to bearer; and

(12) Such other and further information as the Commission may require to be supplied by amendment. Attach as an exhibit an opinion of counsel stating whether any courts, State commissions or other governmental bodies are required to pass upon the transactions to be carried out

pursuant to the proposed plan, giving the status of any proceedings then pending before any such bodies and expressing an opinion as to whether, upon the taking of specified further steps, the plan will become binding upon owners of securities of and claims against the company, who do not consent thereto. Such opinion shall cite the relevant constitutional, statutory and charter provisions and the controlling court decisions, if any, with respect to the jurisdiction of such bodies and with respect to the conditions upon which the plan will become binding upon the owners of securities of and claims against the company who do not consent thereto.

(b) Any such application for a report on a reorganization plan may include as a part thereof such additional statements as are required by §250.12e-5 for a declaration by the applicants in respect of a solicitation of proxies, consents, dissents or requests for the deposit of securities, in connection with such plan and every application containing such statements shall be deemed to constitute both an application under this section and a declaration under said § 250.12e-5.

[Rule U-12E-4, effective July 26, 1937, 2 F. R. 1342]

SUPREME COURT OF THE UNITED STATES

Nos. 81 AND 82.—OCTOBER TERM, 1946.

Securities and Exchange Commission, Petitioner, 81 v. Chenery Corporation, et al.	On Writs of Certiorari to the United States Court of Appeals for the District of Columbia.
Securities and Exchange Commission, Petitioner, 82 v. Federal Water and Gas Corporation.	

[June 23, 1947.]

MR. JUSTICE MURPHY delivered the opinion of the Court.

This case is here for the second time. In *S. E. C.* v. *Chenery Corp.*, 318 U. S. 80, we held that an order of the Securities and Exchange Commission could not be sustained on the grounds upon which that agency acted. We therefore directed that the case be remanded to the Commission for such further proceedings as might be appropriate. On remand, the Commission reexamined the problem, recast its rationale and reached the same result. The issue now is whether the Commission's action is proper in light of the principles established in our prior decision.

When the case was first here, we emphasized a simple but fundamental rule of administrative law. That rule is to the effect that a reviewing court, in dealing with a determination or judgment which an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency. If those grounds are inadequate or improper, the court is powerless to affirm the administrative action

by substituting what it considers to be a more adequate or proper basis. To do so would propel the court into the domain which Congress has set aside exclusively for the administrative agency.

We also emphasized in our prior decision an important corollary of the foregoing rule. If the administrative action is to be tested by the basis upon which it purports to rest, that basis must be set forth with such clarity as to be understandable. It will not do for a court to be compelled to guess at the theory underlying the agency's action; nor can a court be expected to chisel that which must be precise from what the agency has left vague and indecisive. In other words, "We must know what a decision means before the duty becomes ours to say whether it is right or wrong." *United States* v. *Chicago, M., St. P. & P. R. Co.*, 294 U. S. 499, 511.

Applying this rule and its corollary, the Court was unable to sustain the Commission's original action. The Commission had been dealing with the reorganization of the Federal Water Service Corporation (Federal), a holding company registered under the Public Utility Holding Company Act of 1935, 49 Stat. 803. During the period when successive reorganization plans proposed by the management were before the Commission, the officers, directors and controlling stockholders of Federal purchased a substantial amount of Federal's preferred stock on the over-the-counter market. Under the fourth reorganization plan, this preferred stock was to be converted into common stock of a new corporation; on the basis of the purchases of preferred stock, the management would have received more than 10% of this new common stock. It was frankly admitted that the management's purpose in buying the preferred stock was to protect its interest in the new company. It was also plain that there was no fraud or lack of disclosure in making these purcheses.

But the Commission would not approve the fourth plan so long as the preferred stock purchased by the manage-

ment was to be treated on a parity with the other preferred stock. It felt that the officers and directors of a holding company in process of reorganization under the Act were fiduciaries and were under a duty not to trade in the securities of that company during the reorganization period. 8 S. E. C. 893, 915–921. And so the plan was amended to provide that the preferred stock acquired by the management, unlike that held by others, was not to be converted into the new common stock; instead, it was to be surrendered at cost plus dividends accumulated since the purchase dates. As amended, the plan was approved by the Commission over the management's objections. 10 S. E. C. 200.

The Court interpreted the Commission's order approving this amended plan as grounded solely upon judicial authority. The Commission appeared to have treated the preferred stock acquired by the management in accordance with what it thought were standards theretofore recognized by courts. If it intended to create new standards growing out of its experience in effectuating the legislative policy, it failed to express itself with sufficient clarity and precision to be so understood. Hence the order was judged by the only standards clearly invoked by the Commission. On that basis, the order could not stand. The opinion pointed out that courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders which precludes them, merely because they are officers and directors, from buying and selling the corporation's stock. Nor was it felt that the cases upon which the Commission relied established any principles of law or equity which in themselves would be sufficient to justify this order.

The opinion further noted that neither Congress nor the Commission had promulgated any general rule proscribing such action as the purchase of preferred stock by Federal's management. And the only judge-made rule of equity which might have justified the Commission's order related

to fraud or mismanagement of the reorganization by the officers and directors, matters which were admittedly absent in this situation.

After the case was remanded to the Commission, Federal Water and Gas Corp. (Federal Water), the surviving corporation under the reorganization plan, made an application for approval of an amendment to the plan to provide for the issuance of new common stock of the reorganized company. This stock was to be distributed to the members of Federal's management on the basis of the shares of the old preferred stock which they had acquired during the period of reorganization, thereby placing them in the same position as the public holders of the old preferred stock. The intervening members of Federal's management joined in this request. The Commission denied the application in an order issued on February 7, 1945. Holding Company Act Release No. 5584. That order was reversed by the Court of Appeals, 154 F. 2d 6, which felt that our prior decision precluded such action by the Commission.

The latest order of the Commission definitely avoids the fatal error of relying on judicial precedents which do not sustain it. This time, after a thorough reexamination of the problem in light of the purposes and standards of the Holding Company Act, the Commission has concluded that the proposed transaction is inconsistent with the standards of §§ 7 and 11 of the Act. It has drawn heavily upon its accumulated experience in dealing with utility reorganizations. And it has expressed its reasons with a clarity and thoroughness that admit of no doubt as to the underlying basis of its order.

The argument is pressed upon us, however, that the Commission was foreclosed from taking such a step following our prior decision. It is said that, in the absence of findings of conscious wrongdoing on the part of Federal's management, the Commission could not determine

by an order in this particular case that it was inconsistent with the statutory standards to permit Federal's management to realize a profit through the reorganization purchases. All that it could do was to enter an order allowing an amendment to the plan so that the proposed transaction could be consummated. Under this view, the Commission would be free only to promulgate a general rule outlawing such profits in future utility reorganizations; but such a rule would have to be prospective in nature and have no retroactive effect upon the instant situation.

We reject this contention, for it grows out of a misapprehension of our prior decision and of the Commission's statutory duties. We held no more and no less than that the Commission's first order was unsupportable for the reasons supplied by that agency. But when the case left this Court, the problem whether Federal's management should be treated equally with other preferred stockholders still lacked a final and complete answer. It was clear that the Commission could not give a negative answer by resort to prior judicial declarations. And it was also clear that the Commission was not bound by settled judicial precedents in a situation of this nature. 318 U. S. at 89. Still unsettled, however, was the answer the Commission might give were it to bring to bear on the facts the proper administrative and statutory considerations, a function which belongs exclusively to the Commission in the first instance. The administrative process had taken an erroneous rather than a final turn. Hence we carefully refrained from expressing any views as to the propriety of an order rooted in the proper and revelant considerations. See *Siegel* v. *Federal Trade Commission*, 327 U. S. 608, 613–614.

When the case was directed to be remanded to the Commission for such further proceedings as might be appropriate, it was with the thought that the Commission would give full effect to its duties in harmony with the views we

had expressed. *Ford Motor Co.* v. *Labor Board*, 305 U. S. 364, 374; *Federal Radio Commission* v. *Nelson Bros. Co.*, 289 U. S. 266, 278. This obviously meant something more than the entry of a perfunctory order giving parity treatment to the management holdings of preferred stock. The fact that the Commission had committed a legal error in its first disposition of the case certainly gave Federal's management no vested right to receive the benefits of such an order. See *Federal Communications Commission* v. *Pottsville Broadcasting Co.*, 309 U. S. 134, 145. After the remand was made, therefore, the Commission was bound to deal with the problem afresh, performing the function delegated to it by Congress. It was again charged with the duty of measuring the proposed treatment of the management's preferred stock holdings by relevant and proper standards. Only in that way could the legislative policies embodied in the Act be effectuated.

The absence of a general rule or regulation governing management trading during reorganization did not affect the Commission's duties in relation to the particular proposal before it. The Commission was asked to grant or deny effectiveness to a proposed amendment to Federal's reorganization plan whereby the management would be accorded parity treatment on its holdings. It could do that only in the form of an order, entered after a due consideration of the particular facts in light of the relevant and proper standards. That was true regardless of whether those standards previously had been spelled out in a general rule or regulation. Indeed, if the Commission rightly felt that the proposed amendment was inconsistent with those standards, an order giving effect to the amendment merely because there was no general rule or regulation covering the matter would be unjustified.

It is true that our prior decision explicitly recognized the possibility that the Commission might have promulgated a general rule dealing with this problem under its statutory rule-making powers, in which case the issue for

our consideration would have been entirely different from that which did confront us. 318 U. S. 92–93. But we did not mean to imply thereby that the failure of the Commission to anticipate this problem and to promulgate a general rule withdrew all power from that agency to perform its statutory duty in this case. To hold that the Commission had no alternative in this proceeding but to approve the proposed transaction, while formulating any general rules it might desire for use in future cases of this nature, would be to stultify the administrative process. That we refuse to do.

Since the Commission, unlike a court, does have the ability to make new law prospectively through the exercise of its rule-making powers, it has less reason to rely upon *ad hoc* adjudication to formulate new standards of conduct within the framework of the Holding Company Act. The function of filling in the interstices of the Act should be performed, as much as possible, through this quasi-legislative promulgation of rules to be applied in the future. But any rigid requirement to that effect would make the administrative process inflexible and incapable of dealing with many of the specialized problems which arise. See Report of the Attorney General's Committee on Administrative Procedure in Government Agencies, S. Doc. No. 8, 77th Cong., 1st Sess., p. 29. Not every principle essential to the effective administration of a statute can or should be cast immediately into the mold of a general rule. Some principles must await their own development, while others must be adjusted to meet particular, unforeseeable situations. In performing its important functions in these respects, therefore, an administrative agency must be equipped to act either by general rule or by individual order. To insist upon one form of action to the exclusion of the other is to exalt form over necessity.

In other words, problems may arise in a case which the administrative agency could not reasonably foresee, prob-

lems which must be solved despite the absence of a relevant general rule. Or the agency may not have had sufficient experience with a particular problem to warrant rigidifying its tentative judgment into a hard and fast rule. Or the problem may be so specialized and varying in nature as to be impossible of capture within the boundaries of a general rule. In those situations, the agency must retain power to deal with the problems on a case-to-case basis if the administrative process is to be effective. There is thus a very definite place for the case-by-case evolution of statutory standards. And the choice made between proceeding by general rule or by individual, *ad hoc* litigation is one that lies primarily in the informed discretion of the administrative agency. See *Columbia Broadcasting System* v. *United States*, 316 U. S. 407, 421.

Hence we refuse to say that the Commission, which had not previously been confronted with the problem of management trading during reorganization, was forbidden from utilizing this particular proceeding for announcing and applying a new standard of conduct. Cf. *Federal Trade Commission* v. *Keppel & Bro.*, 291 U. S. 304. That such action might have a retroactive effect was not necessarily fatal to its validity. Every case of first impression has a retroactive effect, whether the new principle is announced by a court or by an administrative agency. But such retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law. See *Addison* v. *Holly Hill Co.*, 322 U. S. 607, 620.

And so in this case, the fact that the Commission's order might retroactively prevent Federal's management from securing the profits and control which were the objects of the preferred stock purchases may well be out-

weighed by the dangers inherent in such purchases from the statutory standpoint. If that is true, the argument of retroactivity becomes nothing more than a claim that the Commission lacks power to enforce the standards of the Act in this proceeding. Such a claim deserves rejection.

The problem in this case thus resolves itself into a determination of whether the Commission's action in denying effectiveness to the proposed amendment to the Federal reorganization plan can be justified on the basis upon which it clearly rests. As we have noted, the Commission avoided placing its sole reliance on inapplicable judicial precedents. Rather it has derived its conclusions from the particular facts in the case, its general experience in reorganization matters and its informed view of statutory requirements. It is those matters which are the guide for our review.

The Commission concluded that it could not find that the reorganization plan, if amended as proposed, would be "fair and equitable to the persons affected thereby" within the meaning of § 11 (e) of the Act, under which the reorganization was taking place. Its view was that the amended plan would involve the issuance of securities on terms "detrimental to the public interest and the interest of investors" contrary to §§ 7 (d) (6) and 7 (e), and would result in an "unfair or inequitable distribution of voting power" among the Federal security holders within the meaning of § 7 (e). It was led to this result "not by proof that the interveners [Federal's management] committed acts of conscious wrongdoing but by the character of the conflicting interests created by the interveners' program of stock purchases carried out while plans for reorganization were under consideration."

The Commission noted that Federal's management controlled a large multi-state utility system and that its influence permeated down to the lowest tier of operating

companies. The financial, operational and accounting policies of the parent and its subsidiaries were therefore under the management's strict control. The broad range of business judgments vested in Federal's management multiplied opportunities for affecting the market price of Federal's outstanding securities and made the exercise of judgment on any matter a subject of greatest significance to investors. Added to these normal managerial powers, the Commission pointed out that a holding company management obtains special powers in the course of a voluntary reorganization under § 11 (e) of the Holding Company Act. The management represents the stockholders in such a reorganization, initiates the proceeding, draws up and files the plan, and can file amendments thereto at any time. These additional powers may introduce conflicts between the management's normal interests and its responsibilities to the various classes of stockholders which it represents in the reorganization. Moreover, because of its representative status, the management has special opportunities to obtain advance information of the attitude of the Commission.

Drawing upon its experience, the Commission indicated that all these normal and special powers of the holding company management during the course of a § 11 (e) reorganization placed in the management's command "a formidable battery of devices that would enable it, if it should choose to use them selfishly, to affect in material degree the ultimate allocation of new securities among the various existing classes, to influence the market for its own gain, and to manipulate or obstruct the reorganization required by the mandate of the statute." In that setting, the Commission felt that a management program of stock purchase would give rise to the temptation and the opportunity to shape the reorganization proceeding so as to encourage public selling on the market at low prices. No management could engage in such a program

without raising serious questions as to whether its personal interests had not opposed its duties "to exercise disinterested judgment in matters pertaining to subsidiaries' accounting, budgetary and dividend policies, to present publicly an unprejudiced financial picture of the enterprise, and to effectuate a fair and feasible plan expeditiously."

The Commission further felt that its answer should be the same even where proof of intentional wrongdoing on the management's part is lacking. Assuming a conflict of interests, the Commission thought that the absence of actual misconduct is immaterial; injury to the public investors and to the corporation may result just as readily. "Questionable transactions may be explained away, and an abuse of investors and the administrative process may be perpetrated without evil intent, yet the injury will remain." Moreover, the Commission was of the view that the delays and the difficulties involved in probing the mental processes and personal integrity of corporate officials do not warrant any distinction on the basis of evil intent, the plain fact being "that an absence of unfairness or detriment in cases of this sort would be practically impossible to establish by proof."

Turning to the facts in this case, the Commission noted the salient fact that the primary object of Federal's management in buying the preferred stock was admittedly to obtain the voting power that was accruing to that stock through the reorganization and to profit from the investment therein. That stock had been purchased in the market at prices that were depressed in relation to what the management anticipated would be, and what in fact was, the earning and asset value of its reorganization equivalent. The Commission admitted that the good faith and personal integrity of this management were not in question; but as to the management's justification of its motives, the Commission concluded that it was

merely trying to "deny that they made selfish use of their powers during the period when their conflict of interest, *vis-a-vis* public investors, was in existence owing to their purchase program." Federal's management had thus placed itself in a position where it was "peculiarly susceptible to temptation to conduct the reorganization for personal gain rather than the public good" and where its desire to make advantageous purchases of stock could have an important influence, even though subconsciously, upon many of the decisions to be made in the course of the reorganization. Accordingly, the Commission felt that all of its general considerations of the problem were applicable to this case.

The scope of our review of an administrative order wherein a new principle is announced and applied is no different from that which pertains to ordinary administrative action. The wisdom of the principle adopted is none of our concern. See *Board of Trade* v. *United States*, 314 U. S. 534, 548. Our duty is at an end when it becomes evident that the Commission's action is based upon substantial evidence and is consistent with the authority granted by Congress. See *National Broadcasting Co.* v. *United States*, 319 U. S. 190, 224.

We are unable to say in this case that the Commission erred in reaching the result it did. The facts being undisputed, we are free to disturb the Commission's conclusion only if it lacks any rational and statutory foundation. In that connection, the Commission has made a thorough examination of the problem, utilizing statutory standards and its own accumulated experience with reorganization matters. In essence, it has made what we indicated in our prior opinion would be an informed, expert judgment on the problem. It has taken into account "those more subtle factors in the marketing of utility company securities that gave rise to the very grave evils which the Public Utility Holding Company

Act of 1935 was designed to correct" and has relied upon the fact that "Abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions not concerned with the fairness of a particular transaction." 318 U. S. at 92.

Such factors may properly be considered by the Commission in determining whether to approve a plan of reorganization of a utility holding company, or an amendment to such a plan. The "fair and equitable" rule of § 11 (e) and the standard of what is "detrimental to the public interest or the interest of investors or consumers" under § 7 (d) (6) and § 7 (e) were inserted by the framers of the Act in order that the Commission might have broad powers to protect the various interests at stake. 318 U. S. at 90–91. The application of those criteria, whether in the form of a particular order or a general regulation, necessarily requires the use of informed discretion by the Commission. The very breadth of the statutory language precludes a reversal of the Commission's judgment save where it has plainly abused its discretion in these matters. See *United States* v. *Lowden*, 308 U. S. 225; *I. C. C.* v. *Railway Labor Assn.*, 315 U. S. 373. Such an abuse is not present in this case.

The purchase by a holding company management of that company's securities during the course of a reorganization may well be thought to be so fraught with danger as to warrant a denial of the benefits and profits accruing to the management. The possibility that such a stock purchase program will result in detriment to the public investors is not a fanciful one. The influence that program may have upon the important decisions to be made by the management during reorganization is not inconsequential. Since the officers and directors occupy fiduciary positions during this period, their actions are to be held to a higher standard than that imposed upon the

general investing public. There is thus a reasonable basis for a value judgment that the benefits and profits accruing to the management from the stock purchases should be prohibited, regardless of the good faith involved. And it is a judgment that can justifiably be reached in terms of fairness and equitableness, to the end that the interests of the public, the investors and the consumers might be protected. But it is a judgment based upon public policy, a judgment which Congress has indicated is of the type for the Commission to make.

The Commission's conclusion here rests squarely in that area where administrative judgments are entitled to the greatest amount of weight by appellate courts. It is the product of administrative experience, appreciation of the complexities of the problem, realization of the statutory policies, and responsible treatment of the uncontested facts. It is the type of judgment which administrative agencies are best equipped to make and which justifies the use of the administrative process. See *Republic Aviation Corp.* v. *Labor Board*, 324 U. S. 793, 800. Whether we agree or disagree with the result reached, it is an allowable judgment which we cannot disturb.

Reversed.

MR. JUSTICE BURTON concurs in the result.

THE CHIEF JUSTICE and MR. JUSTICE DOUGLAS took no part in the consideration or decision of these cases.

MR. JUSTICE FRANKFURTER and MR. JUSTICE JACKSON dissent, but there is not now opportunity for a response adequate to the issues raised by the Court's opinion. These concern the rule of law in its application to the administrative process and the function of this Court in reviewing administrative action. Accordingly, the detailed grounds for dissent will be filed in due course.